RESOLUTION NO. 2006-177

A RESOLUTION OF THE LODI CITY COUNCIL APPROVING PROGRAM GUIDELINES OF THE REVOLVING LOAN FUND FOR THE CITY OF LODI'S ECONOMIC DEVELOPMENT JOBS PROGRAM

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NOW, THEREFORE, BE IT RESOLVED that the Lodi City Council hereby approves the program guidelines (hereto attached as Exhibit A) for the Revolving Loan Program for the City of Lodi's Community Development Block Grant Economic Development Jobs Program.

Dated: September 20, 2006

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I hereby certify that Resolution No. 2006-177 was passed and adopted by the City Council of the City of Lodi in a regular meeting held September 20, 2006, by the following vote:

AYES: COUNCIL MEMBERS – Beckman, Hansen, Mounce, and Mayor Hitchcock

NOES: COUNCIL MEMBERS – None

ABSENT: COUNCIL MEMBERS – Johnson

ABSTAIN: COUNCIL MEMBERS – None

Jennifer M Perrin

JENNIFER M. PERRIN
Interim City Clerk

EXHIBIT A

CITY OF LODI
REVOLVING BUSINESS LOAN FUND

PROGRAM GUIDELINES

PURPOSE
The City of Lodi Revolving Loan Fund (RLF) is designed to meet the capital needs of businesses located in or moving to the City of Lodi. An RLF, in this context, refers to a loan program in which loan repayments are "revolved" or "recycled" to be loaned again in the same program

The RLF will provide appropriate assistance to businesses, which in turn create full time jobs while increasing the overall economic base of the community.

- The RLF is designed to provide no more than one-quarter of a project's total financing requirements.
- The RLF will only provide the funds necessary to bridge the financial gap that allows the project to move forward.
- The RLF is targeted to businesses that have the greatest potential for long-term job creation, primarily benefiting persons in the Targeted Income Group[1](TIG) – which is a national objective of the HUD CDBG program. In addition, priority will be given to projects with other local public benefits, such as contribution to the City's tax base, and local investment.

SOURCE OF FUNDING
The source of the funding for the RLF is the Community Development Block Grant Program (CDBG) of the federal Department of Housing & Urban Development (HUD) through the County of San Joaquin, and the repayment of principal and interest from existing loans. Federal requirements are incorporated into the use of these funds.

GUIDELINES AND FEATURES
There is no minimum or maximum RLF loan amount. Borrowers must, however create at least one full time equivalent job for each $35,000, or fraction thereof, they receive in RLF assistance.

The following guidelines have been adopted to clarify the program basis for making loan commitment decisions.

- **Leveraging:** The RLF Program's overall goal is to leverage at least three private dollars from equity and/or debt for every RLF dollar loaned. On a case-by-case basis with projects involving large job creation, this leverage requirement may be relaxed. Owner equity can be cash and/or land. Land will only be counted for construction projects. Expenditures made by the loan applicant prior to the RLF loan award are not counted unless made as part of the submittal, and made within 60 days of the application

[1] A household whose annual income is less than 80% of the county median income as defined by the County of San Joaquin CDBG Program. The income amounts change annually. See Attachment A for 2006 income levels.

submittal to the RLF, and are related to and in anticipation of RLF funding. If the equity requirement is relaxed for a project, additional collateral will be required.

- **Loan Terms:** Not to exceed seven (7) years depending on the asset being financed, the financial gap, and the demonstrated need for the RLF funds. This is subject to participating lender criteria and the quality of collateral. A call provision prior to the loan maturity date may be incorporated.
- **Interest Rate:** The interest rate is set based on the business needs and financial gap of each loan. If the financial gap is the availability of capital, the interest rate shall be near market rates for the asset being financed. If the financial gap is the cost of capital (rate, term or collateral requirements), then the interest rate is set by evaluating the businesses financial condition to determine at what interest rate the proposed project and job creation become viable.
- **Loan Fees:** There is no fee charged for the Phase 1 of the loan application process, the Initial Phase. The fees for loan processing in the Second Phase range from .5 percent (.5%) to three percent (3%) of the loan amount requested, depending upon the specifics of the loan. The applicant must pay for any special services required for the loan analysis, such as title search special environmental studies, and appraisals.
- **Prepayment Penalty:** None
- **Deferral Payments:** On a case-by-case basis, payments may be deferred if warranted by the financial needs of the business.
- **Job Creation:** At least one full time equivalent job (1,750 hours annually) per $35,000 provided (or fraction thereof) must be achieved for each business assisted. Two permanent part-time jobs (at least 875 hours annually) can be aggregated to count as one full time equivalent job in the same project. At least 51% of all jobs created/retained shall be held by Targeted Income Group (TIG) persons. See Attachment "A" for Current Income Limits of Targeted Income Group.
- **Collateral Requirements:** All RLF loans are to be fully secured for 100% collateral coverage to maintain the RLF Program. No unsecured loans shall be made. Types of collateral may include one or more of the following:
  - Real Estate – liens on real property supported by appraisals establishing sufficient equity generally utilizing a 100% loan to value ratio.
  - Deeds of Trust.
  - Liens on RLF financed machinery, equipment, or other fixtures, generally a 95% loan to value ratio.
  - Assignment of Rents, as appropriate.
  - Personal and/or Corporate Guarantees, as appropriate.
  - Cosigners and other collateral such as insurance on principals.
  - Other collateral, as appropriate.

GENERAL ADMINISTRATIVE FEATURES

- NEPA Environmental Review of business project.
- Equal Opportunity/Affirmative Action Policy.
- Attorney review of all contracts and legal forms.
- Monitoring and reporting forms.
- Collection and foreclosure policy.
- Compliance with HUD program regulations.

- Federal and State Labor Standards where applicable.

GENERAL CREDIT REQUIREMENTS

The following general credit criteria will be applied by the RLF. These requirements must be satisfied in conjunction with the provisions of RLF assistance so that the assistance is not allowed to compensate for deficiencies in these criteria. An Applicant must:

- Demonstrate the ability to operate the same type of business successfully for 3 years, or document the contracted expertise necessary to offset deficiencies in the principal's background or training.
- If circumstances warrant, agree to attend Small Business Development Center business plan, financial and marketing courses. Have enough financial strength and borrowing ability or equity to operate with the RLF assistance, on a sound financial basis.
- Show that the proposed assistance is reasonably secured to assure repayment.
- Show that the past earning record and future prospects of the business indicate ability to repay the loan and other fixed debt, if any, from the operation of the business.

ELIGIBLE APPLICANTS

Eligible applicants include on-going private, for profit business concerns, corporations, partnerships, and sole proprietorships that are classified as industrial, commercial or retail businesses, and that are located in or expanding to the City of Lodi. The project to be financed with the RLF Program must be within the incorporated area of the City of Lodi.

ELIGIBLE COSTS

- Infrastructure and off-site improvements.
- Land costs, including engineering, legal, grading, testing, site mapping and related costs associated with the acquisition and preparation of land.
- Building construction costs, including real estate, engineering, architectural, legal and related costs associated with acquisition, construction and rehabilitation of buildings and tenant improvements. (See note below regarding Labor Standards and Prevailing Wage.)
- Purchase of inventory, furniture, fixtures, machinery and equipment.
- Impact/Mitigation fees.

Special Note

The use of loan funds in private construction triggers federal Labor Standards and requires the payment of Prevailing Wage. In addition, the use of loan funds for any of the eligible costs may trigger state Prevailing Wage. This is determined on a case by case basis, and should be discussed with loan staff as early in the process as possible.

INELIGIBLE USES

- Projects which do not meet the purpose of the program are not eligible.
- Costs incurred prior to CDBG grant execution, or prior to submittal of the loan application, and prior to environmental review completion are ineligible, except for private expenditures specifically identified in the application.
- Projects, which are not located in the City of Lodi.
- Projects which involve the relocation of residents or businesses.

- Projects that propose the refinancing of existing debt are not eligible.
- Projects are not eligible if they create a conflict of interest pursuant to California Government Code Section 87100 et seq. for any current City elected official, appointed official, or employee.

OPERATION OF THE PROGRAM

The City of Lodi Business Revolving Loan Program will be operated through a combination of public and private services. The City retains the option to modify these service providers, once the program has gotten underway and the City has experience with it.

City of Lodi

- Oversight of the program
- Agreements for service with County Business RLF, and Farmers & Merchants Bank, and/or other future service providers.
- Appoints the Loan Advisory Committee.
- Marketing and initial screening of potential applicants.
- Attends Loan Advisory Committee meeting for each loan presentation.
- Annual reporting to San Joaquin County CDBG program on status of business loans, jobs created, and use of CDBG funds.
- Approval or denial of individual loans recommended by Loan Advisory Board.
- Legal review of documents
- Execution of loan documents
- Release of funds.
- Collection process
- Liaison responsibility with County CDBG program and service providers.

City's Program Operator, San Joaquin County Revolving Loan Fund

- Assist the business applicant with application process in the Second Phase of the application process.
- Conduct loan underwriting, using HUD underwriting guidelines.
- Prepare Credit Memo for Loan Advisory Committee (LAC) and present to LAC.
- Transmit the LAC action to the City Manager, with draft approval letter.
- Once loan has been made, provide loan servicing.
- Collect annual job and financial reporting from borrowers, and submit annual loan program activity report to City.
- Provide income verification process to certify Targeted Income Group benefiting from created jobs.

Farmers & Merchants Bank

- Obtain software to be used for City loan program documents.
- Prepare loan documents for each loan.
- Conduct loan closing on each loan.

LOAN APPLICATION

Initial Phase

Based upon information provided by the potential applicant, a committee of City staff will review the project for loan application appropriateness and eligibility. The Committee will be composed of the City Manager, Deputy City Manager, and Community Development Director. No fee will be charged for this phase.

Information to be provided by the potential applicant includes:

- Description of the business and project,
- Amount of loan funds requested,
- Number of jobs to be created and potential for TIG benefit
- Other public benefits
- Intended use of the funds
- Project timing and job creation timing
- Leverage and status of funding
- Environmental considerations
- Principals of the business and business plan.

Second Phase

In the event the potential project has been determined to be an eligible project and appropriate for CDBG loan consideration, the applicant will complete a Lodi Revolving Loan Fund Application.

In the Second Phase of the loan application process, the County Business Loan Program will act as the City's representative and primary contact as the loan applicant compiles all necessary loan application documents. The County Business Loan Program will conduct the loan underwriting process, using HUD Underwriting Guidelines, which are attached to these Guidelines. City staff will provide oversight to the program and all aspects of it.

As a result of the loan underwriting process, a Credit Memo will be prepared with an analysis of the loan and the recommended action to be taken. If a loan is recommended for approval, the Credit Memo will contain the loan structure, including terms and conditions. The Credit Memo will be sent to the Loan Advisory Committee.

LOAN REVIEW

The Loan Advisory Committee (LAC) is responsible for reviewing loan applications as forwarded through the Credit Memo provided by the City's Program Operator, the County RLF Program. The recommendations of the Loan Advisory Committee are made in writing to the City Manager. The City Manager will make the final decision on approval or denial of all loan applications submitted, including terms and conditions of loan agreements. All projects moving forward from the Initial Screening Phase and completed Loan Applications will be brought before the LAC.

The Loan Advisory Committee shall be composed of 3-5 persons and appointed by the City Manager. The appointments will be persons with business and/or banking experience.

On average, the RLF review process takes six to eight weeks from submittal of a complete loan application through Loan Advisory Committee review. Every effort will be made to facilitate the process to coincide with the other funding sources and the project's requirements.

LOAN CLOSING

Once the loan is approved, final loan documents will be prepared by the Farmers & Merchants Bank. The bank, acting as the city's representative, will conduct the loan closing, with oversight by City staff.

LINKING JOBS WITH TARGETED INCOME GROUP PERSONS

To assist with the job creation to benefit Targeted Income Group persons, the business will be required to sign a First Source Hiring Agreement, which commits the borrower to use the services of WorkNet, the San Joaquin County job training program, as the first source from which to hire new employees. WorkNet is accustomed to assisting employers to find workers within its clientele, and has an office in Lodi. Referrals from WorkNet will have undergone the income verification process which documents their Targeted Income Group status.

In the event the business does not hire from Worknet, the City's Program Operator, the County Business RLF, will conduct the income verification of job applicants. At least 51% of the jobs created as a result of the loan funds must be filled by persons from the Targeted Income Group.

IF JOBS NOT CREATED

In the event the business does not create the jobs as specified in the Loan Agreement and related documents, the City will declare the loan in default and require full repayment.

HOW TO GET STARTED

Please take time to read and understand the information outlined above. If you are interested in learning more about the program, please contact:

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ATTACHMENT A
CURRENT TARGET INCOME GROUP INCOME LEVELS

	Percent of Median Income			
		Very-Low		Low
Family Size	0-30%	31-50%	51-60%	61-80%
1	11,986	19,977	23,972	31,963
2	13,709	22,848	27,417	36,556
3	15,431	25,719	30,862	41,150
4	17,130	28,550	34,260	45,680
5	18,499	30,831	36,997	49,330
6	19,890	33,151	39,781	53,041
7	21,259	35,432	42,518	56,691
8	22,628	37,713	45,256	60,341
9	23,965	39,941	47,930	63,906
10	25,352	42,254	50,705	67,606
11	26,723	44,538	53,446	71,261
12	28,093	46,822	56,186	74,915
13	29,464	49,106	58,927	78,570

Note: These figures change annually, and are provided by the San Joaquin County CDBG Program.

ATTACHMENT B
LOAN UNDERWRITING GUIDELINES

The loan underwriting policies of the City of Lodi RLF are designed to assist businesses that could not proceed without the RLF assistance and to ensure that the RLF assistance is "appropriate" as defined by HUD.

HUD UNDERWRITING GUIDELINES

The City of Lodi has adopted the HUD underwriting guidelines to determine whether a proposed RLF subsidy is ***appropriate*** to assist the business expansion or retention. In addition, the project will be reviewed to determine that a minimum level of ***public benefit*** will be obtained from the expenditure of the CDBG funds.

The objectives of the underwriting guidelines are to ensure that:

Project costs are reasonable.
All sources of project financing are committed.
RLF funds are not substituted for non-Federal financial support.
The project is financially feasible.
The return on the owner's equity investment will not be unreasonably high.
RLF funds are disbursed on a pro rata basis with other financing provided to the project.
Sufficient public benefit will be received from the expenditure of RLF funds.

Project Costs: All project costs will be reviewed for reasonableness, and to avoid providing either too much or too little RLF assistance. The amount of time and resources expended evaluating the reasonableness of a cost element shall be commensurate with its costs. In some instances, it will be necessary to obtain third-party fair-market price quotations or a cost estimate. Particular attention will be focused on documenting the cost elements in a non-arm's length transaction.

Commitment of All Sources of Project Financing: Prior to the commitment of RLF funds to the project, a review shall be conducted to determine if sufficient sources of funds have been identified and committed to the project, the Borrower and participating lenders have the financial capacity to provide the funds, and to ascertain if the project is viable and will move ahead in a timely manner. In certain circumstances, the RLF may commit its funds in advance of final commitments from other funding sources. However, to conduct the underwriting analysis, the approximate terms and conditions of the other funding sources should be known. Final commitments from the other funding sources will be required, with substantially similar terms and conditions as used in the underlying analysis, prior to any loan closing or disbursement of funds.

Avoid Substitution of RLF Funds for Non-RLF Financial Support: The project will be reviewed to ensure that, to the extent practicable, RLF funds will not be used to substantially reduce the amount of non-RLF financial support for the project.

In order to receive RLF funds, a project must have a "financial gap." This gap must be documented. There are three types of financial gaps, two are discussed below, and the third is discussed under the criterion "Return on Equity Investment." One project may have two different gaps. The types of gaps are as follows:

<u>Unavailability of Capital:</u> The project can afford the cost of financing, but is unable to obtain the funds from either debt and/or equity sources. In regard to debt, the gap may be a result of a lender's loan to value requirements or the inherent risk of the industry or project. For example, the lender will only loan 70% of the project's cost. In this case, the business may not have the cash to bridge the gap, or if the business bridges the gap, its cash flow may be so restricted as to jeopardize the business. In order to document this gap, several steps need to be undertaken. The lender needs to be contacted to determine if there is any ability to increase the size of their loan. Other lending sources, both public and private, need to be explored. This includes looking at the business owner(s) personal financial statements for potential funds, including home equity loans. Finally, in addition to looking at the business and personal financial statements and tax returns, a proforma cash flow analysis needs to be prepared and analyzed, with and without RLF funds, to demonstrate the gap. The terms and conditions of a loan under this gap analysis should be comparable to the market.

<u>Cost of Capital:</u> The project cannot support the interest rate, loan term and/or collateral requirements of a lender. In analyzing this gap, discussions with the lender are important to determine any flexibility in terms. A single project may not be able to support the rate, terms and collateral requirements, or may just face a single hurdle. In addition, the gap may only exist in the early years of the project. To determine the gap, business and personal financial statements and tax returns shall be analyzed. Sources of equity shall be explored. Public and private funding sources that would bridge the gap shall be evaluated. Proforma cash flow analysis shall be developed with and without the RLF funds to demonstrate the gap. Depending on the gap, the terms or rate shall be adjusted to a rate that allows the project to proceed but are not too generous. Terms can be adjusted to allow for deferrals of principal and or interest, or to allow loans to be amortized over a longer period. Interest rates can be adjusted, including increases in the rate over time as cash flow allows.

Financial Feasibility of the Project: Each project will be examined to determine the financial viability of the project, and thus the reasonable assurance that the public benefit will be realized. The current and past financial statements for both the business and individuals must be analyzed, along with tax returns and projections. The assumptions behind the projections must be critically analyzed. Income and expense costs shall be evaluated and compared historically, where applicable, and compared to industry averages (using guides such as Robert Morris Annual Financial Statements). Project costs, including both hard and soft costs, must be determined to be reasonable. Accurate project costs are vital to determining project feasibility. As part of the financial analysis, the past, current, and projected financial data shall be analyzed to determine if the job estimates are reasonable and supportable. Labor costs shall be gauged at the break-even point. In addition, labor costs shall be checked against industry averages. Any variations shall be explained in the loan analysis.

The terms and conditions of the RLF loan must be "appropriate." In general, the interest rate shall be set at a rate where available cash flow is able to meet debt obligations, after other obligations are met, with enough cash flow remaining to operate successfully. The loan term typically is based on the asset being financed. The term should not exceed the economic life of the asset being financed. However a longer loan amortization schedule, with the loan due at the end of the economic life may be justifiable.

Each loan shall include a written explanation of the "appropriate" analysis that was undertaken, and the reason the terms and conditions of the loan were approved. Each loan decision shall also contain a certification statement by the City Manager that the loan has been reviewed according to all underwriting guidelines and regulations and that the loan is appropriate by state/federal definition.

Financial Analysis: Historical and projected financial statements will be subject to financial analysis to determine the gap, and structure the terms and conditions of the RLF loan, as discussed above, but also to determine that the project is feasible. In addition, using prudent underwriting guidelines, demonstrate that the proposed loan is of sound value and that past earnings and future prospects indicate an ability to meet debt obligations out of profit.

Information required to be submitted by the applicant will depend on the project, ownership structure and whether it is an ongoing or start-up business. In general, the information required is outlined in the RLF checklist that will be provided.

The financial analysis will be designed to evaluate the business. The analysis will include a spread of the current and past financial statements to determine trends. The proforma statements will then be compared to these statements. Key financial ratios will be analyzed. The statements and key ratios will be compared to industry averages. Key ratios that will be analyzed include:

> <u>Current Ratio:</u> current assets/current liabilities. The ratio is a rough indication of a firm's ability to service its current obligations. A ratio of 2:1 will be considered secure.
>
> <u>Quick Ratio:</u> cash and equivalents plus accounts & notes receivable/current liabilities. This ratio is a refinement of the current ratio. A ratio of 1:1 will be used to demonstrate ample liquidity.
>
> <u>Cash Flow Coverage:</u> net profit and depreciation and depletion-amortization expenses/current portion of long-term debt. This ratio will be used to measure the ability to service long term debt. This ratio is a measure of a firm's ability to meet interest payments. A cash flow coverage of 1.25 times debt service shall be used as a guideline.
>
> <u>Debt to Worth:</u> total liabilities/tangible net worth. This ratio is the relationship between debt and a businesses net worth. A lower ratio is an indication of greater long-term financial safety and greater flexibility to borrow. In general, a debt to worth ratio of

higher than 5:1 shall not be exceeded as an underwriting policy. There are exceptions when the industry average is high due to its capital intensive nature or when projections show the ratio lowering quickly.

Collateral Coverage: The value of collateral is compared to the amount of the loan. Typical underwriting guidelines suggest that 125% of loan balance be used. This ratio is highly dependent on the quality and security of the collateral. The Lodi RLF shall use 100% as a guideline, which shall only be lowered with specific and detailed analysis and explanation.

Break-even Analysis: The analysis of the project's ability to support the projected labor costs and additional debt service at its break-even point (BEP) will be analyzed to determine what proportion of the jobs can be supported at that BEP. This will serve as a worst case look at the business prospects for success, ability to service new debt, and meet job creation/retention obligations.

The financial and ratio analyses must be supported by the business plan. The business plan must provide a clear understanding of the project, competition, market strategy, sales estimates, management capacity and other factors.

Lastly, to ensure project feasibility, an evaluation will be conducted of the experience and capacity of the business principals to manage the business and achieve the projections.

Return on Equity Investment: The return on equity investment is the amount of cash that the investor/business owner is projected to receive in relation to their initial equity. For a sole proprietor, this equates to salary plus net income. The RLF should not provide more than a reasonable return on investment to the business owner. This will help ensure that the RLF will maximize the use of RLF funds and not unduly enrich the business owner(s)/investor(s). However care shall be taken to ensure that the rate of return will not be too low so that the business owner's motivation remains high to pursue the business with vigor.

If the project's financial returns are projected to be too low to motivate the business and/or investor to proceed with the project, the risks of the project may outweigh the returns. An inadequate rate of return adjusted for industry and locational risks, is a third method used to determine the gap appropriate to be funded with RLF funds. To analyze this gap, the projected return on investment must be compared to the return on investment on similar projects. If it is shown that a gap does exist then the RLF financing rate and terms must be set at a rate which provides a return equal to the "market rate." Real estate appraisers and lenders will be used as sources of information on "market rate" returns.

Disbursement of RLF Funds on a Pro Rata Basis: To the extent practicable, RLF funds should be disbursed on a pro rata basis with other funding sources to avoid placing RLF funds at a greater risk than other funding sources. When it is determined that it is not practicable to disburse RLF funds on a pro rata basis, other steps shall be taken to safeguard RLF funds in the event of a default.

Standards for Evaluating Public Benefit: Each project will be reviewed to determine if a minimum level of public benefit will be obtained from the expenditure of RLF funds. The minimum standards are:

- Project site within the incorporated boundaries of the City of Lodi.
- The project must lead to the creation or retention of at least one full-time equivalent job per $35,000 or fraction thereof of RLF funds borrowed.
- The timing of job creation must be reasonable in relation to the receipt of RLF assistance.